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IN THE

Supreme Court of the United States

STONERIDGE INVESTMENT PARTNERS, LLC,

Petitioner,

v.

SCIENTIFIC-ATLANTA, INC. and MOTOROLA, INC.,

Respondents.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF OF THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION AND FUTURES INDUSTRY ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

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INTERESTS OF *AMICI CURIAE*[1]

Amicus SIFMA brings together the shared interests of more than 650 securities firms, banks, and asset managers that have a vital interest in the outcome of this appeal. These institutions are the gateway to the U.S. capital markets, linking thousands of companies to millions of investors. Among other things, they underwrite equity and debt offerings for domestic and foreign issuers, broker securities trades, provide financial advisory services, publish analysis, lend money to companies ranging from small start-ups to the Fortune 100, and make private-equity investments in large and small companies. In short, these financial institutions are essential to every aspect of the U.S. (and global) capital markets' function. SIFMA's mission is to promote policies and practices that expand and perfect markets, foster the development of new products and services, and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally through offices in New York, Washington, D.C., and its associated firm, the Asia Securities Industry and Financial Markets Association, in Hong Kong.

Amicus FIA is a national trade association for the commodity futures and options industry. Its regular membership consists of 35 of the nation's largest futures brokerage firms, and its associate membership consists of approximately 150 firms involved in virtually all other segments of the industry. Many of FIA's members also are securities broker-dealers, investment banks, commercial-bank affiliates, or are otherwise extensively involved in capital market and business transactions.

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[1] Letters of consent from both parties have been filed with the clerk. The Securities Industry and Financial Markets Association ("SIFMA") and the Futures Industry Association ("FIA") state that under Rule 37.6, no counsel for a party authored this brief in whole or in part. No person or entity other than SIFMA, FIA, their members, or counsel made a monetary contribution to this brief's preparation or submission.

This case is enormously important to these financial institutions and the U.S. capital markets. Much like the vendors that petitioner Stoneridge Investment Partners ("Stoneridge") sued in this case, financial institutions routinely provide a broad range of services to and engage in counterparty transactions with public issuers. If Stoneridge's positions were accepted, these institutions would face unprecedented liability risk and litigation expense from private securities-fraud litigation brought by shareholders of issuers that later misreport those transactions in their financial statements. Nothing in the relevant statutory framework, caselaw, or public policy supports such a result.

SUMMARY OF ARGUMENT

The federal securities laws guard against fraud by imposing duties on certain parties in certain contexts to disclose material information. But those duties do not apply equally to all commercial actors. In *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*,[2] for example, the Court held that Section 10(b) does not give rise to "aiding-and-abetting" or conspiracy liability.[3] And since 1994, Congress has consistently reaffirmed *Central Bank*'s wisdom by amending the statute to empower only the SEC to sue securities-fraud aiders and abettors, while further restricting Section 10(b)'s implied private right of action.

Foreshadowing cases like this one, the *Central Bank* dissent correctly predicted that private plaintiffs would recast aiding-and-abetting allegations as primary violations:

> [M]any aiders and abettors will be subject to liability as primary violators. For example, an accountant, lawyer, or other person making oral or written misrepresentations (or omissions, *if the person owes a duty to the injured purchaser or seller*) in connection with the purchase or sale of securities

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[2] 511 U.S. 164 (1994).

[3] *See id.* at 177–78.

> may be liable for a primary violation of § 10(b) and Rule 10b-5.[4]

Thus, the dissent recognized the settled law that a silent secondary actor's failure to disclose could constitute a primary Section 10(b) violation only if the actor had a duty to disclose.

If Section 10(b) did not require that duty as a condition to liability in the nondisclosure context, every routine commercial or financial transaction with a public issuer would become a minefield of private securities-fraud liability exposure. Once an issuer misreports the transaction, shareholder-plaintiffs could sue every anonymous third party that played a role, even if that party never uttered a word publicly. The resulting specter of Rule 10b-5 liability would force every commercial actor to disclose all material information to every other counterparty and its shareholders or other constituents. In this case, the only way that Scientific-Atlanta and Motorola could have protected themselves from potential liability would have been to leapfrog Charter and make a specific disclosure (possibly violating a confidentiality agreement) to *Charter's* shareholders, complete strangers with whom Scientific-Atlanta and Motorola otherwise would never have interacted or communicated.

That is why Stoneridge's scheme-liability theory fails. The duty to make truthful disclosures to Charter's shareholders belonged exclusively to Charter, and thus only Charter could have breached that duty in violation of Section 10(b). At most, Scientific-Atlanta's and Motorola's alleged participation in sham transactions that Charter used to falsify its financials may constitute aiding and abetting securities fraud. But absent their own misstatements or a duty to speak, Scientific-Atlanta and Motorola cannot be found to have committed primary Section 10(b) violations.

Eliminating the duty requirement would especially prejudice financial institutions that routinely provide financial services to or engage in counterparty transactions with public

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[4] *Id.* at 199 n.10 (citations omitted) (emphasis added).

issuers. These institutions would effectively be charged with ensuring the *issuers'* compliance with federal securities laws. Unless the financial institutions prepared their own disclosures (or closely supervised their clients' disclosures), they would regularly face exposure to classes of securities holders to whom they never made any statements or owed any duties, and with whom they never transacted business. The ripple effects of such a regime—which several lower courts adopted after *Central Bank*—are living proof of the harm to the very investor-base that Stoneridge and its *amici* claim to champion. Added transaction and compliance costs put the U.S. capital markets out of reach (or at least make them unattractive) for many issuers and increase the cost of capital prohibitively for many others, driving them to foreign markets and deterring foreign issuers from raising capital in the U.S. The result is fewer opportunities for American investors.

Contrary to Stoneridge's and its *amici*'s shrill cry, an affirmance here would not encourage financial institutions to participate in sham transactions that issuers might use to falsify their financial statements. Financial institutions already face serious consequences for aiding and abetting an issuer's securities-law violations. First and foremost, they can be put out of business as a practical consequence of criminal prosecution. They can also be sued by the SEC or self-regulatory organizations (SROs) (for aiding and abetting the issuer's fraud, or for violating other rules and regulations applicable to financial institutions), and by state regulators and attorneys general (under broad anti-fraud statutes like New York's Martin Act). There is thus no need to distort Section 10(b)'s longstanding duty requirement by recharacterizing classic aiding-and-abetting conduct as a "primary violation."

ARGUMENT

I. A NON-DUTY-BASED SCHEME-LIABILITY REGIME WOULD MULTIPLY LITIGATION EXPOSURE AND INCREASE THE COST OF CAPITAL IN U.S. MARKETS.

At bottom, Stoneridge's espoused theory of "scheme liability" is nothing more than an impermissible private right of action for aiding and abetting securities fraud. Indeed, the Tenth Circuit Court of Appeals in *Central Bank* found the bank's "affirmative" participation in the issuer's "fraudulent scheme" to constitute aiding and abetting (which the court erroneously concluded was actionable).[5] Nonetheless, Stoneridge argues that its allegations regarding Scientific-Atlanta's and Motorola's alleged affirmative participation in Charter's fraudulent scheme fit within *Central Bank*'s description of a "primary" violation. This argument fails because Stoneridge cannot allege against Scientific-Atlanta and Motorola Section 10(b)'s central requirement—a duty to disclose.

A. Section 10(b) and Rule 10b-5 address fraud by imposing disclosure duties on certain market participants.

The Court has repeatedly observed that the securities laws' "fundamental purpose" is to promote "full disclosure."[6] Section 10(b) furthers that purpose by prohibiting the use or employment of "any manipulative or deceptive device or contrivance in

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[5] *First Interstate Bank of Denver, N.A. v. Pring*, 969 F.2d 891, 895, 902 (10th Cir. 1992) (sustaining aiding-and-abetting claim against Central Bank where plaintiffs had alleged that securities "were sold as part of a fraudulent scheme" that Central Bank assisted "by affirmative action, specifically by affirmatively agreeing to delay the independent review of the" property appraisal).

[6] *See, e.g.*, *Cent. Bank*, 511 U.S. at 171; *Schreiber v. Burlington N., Inc.*, 472 U.S. 1, 8 (1985); *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972); *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963).

contravention of such rules and regulations as the [SEC] may prescribe."[7]

SEC Rule 10b-5 and its three subsections effectuate this mandate. Specifically, Rule 10b-5(b) bars *incorrect* and *incomplete* disclosure by imposing a duty on speakers to be truthful and complete—it prohibits "any untrue statement of material fact" or omission "to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading."[8] Rules 10b-5(a) & (c), in contrast, address conduct that does not involve speaking, and thus apply even where there is *no* disclosure. They prohibit "any device, scheme, or artifice to defraud"[9] and "any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."[10]

The failure to disclose is essential to Rule 10b-5(a) & (c) liability because there can be no "fraud or deceit" where the nature of the "device, scheme, or artifice" is fully disclosed. In *Santa Fe Industries, Inc. v. Green*, for example, the plaintiff shareholders were "furnished with all relevant information on which to base their decision" either to approve a proposed short-form merger or reject it and exercise their share-appraisal rights.[11] Because "the complaint failed to allege a material misrepresentation or material failure to disclose," the transaction was "neither deceptive nor manipulative and therefore did not violate either § 10(b) of the Act or Rule 10b-5."[12] Just as full

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[7] *See* 15 U.S.C. § 78j(b) (2007).

[8] 17 C.F.R. § 240.10b-5(b) (2007).

[9] *Id.* § 240.10b-5(a).

[10] *Id.* § 240.10b-5(c).

[11] 430 U.S. 462, 474 (1977).

[12] *Id.*; *see also United States v. O'Hagan*, 521 U.S. 642, 655 (1997) ("[F]ull disclosure forecloses liability under the misappropriation theory [of insider trading]: Because the deception essential to the

(Cont'd)

disclosure precludes a fraud claim, the failure to disclose can create one. The Court first made this observation in *Affiliated Ute Citizens v. United States*, when it found that the acts of the defendants—bank employees who had contracted to facilitate Ute tribe members' stock sales to outsiders (including the defendants themselves)—"operated as a fraud . . . because the defendants devised a plan and induced the [plaintiffs] to dispose of their shares *without disclosing to them* material facts that reasonably could have been expected to influence their decisions to sell."[13] Regardless of the specific "act, practice, or course of business"[14] that brought the defendants within the rule, it was their failure to disclose that rendered their conduct fraudulent.

Nondisclosure also underlies the fraud alleged here. As Stoneridge's *amici* concede, "had the truth behind Charter's financial statements been disclosed, there would have been no injury."[15] That is, had Charter announced the terms of its transactions with Scientific-Atlanta and Motorola (rather than just Charter's revenue data), the market would have recognized the transactions for what they were.[16] Thus, the transactions

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(Cont'd)
misappropriation theory involves feigning fidelity to the source of information, if the fiduciary discloses to the source that he plans to trade on the nonpublic information, there is no 'deceptive device' and thus no § 10(b) violation . . . .").

[13] 406 U.S. 128, 153 (1972) (emphasis added); *see also SEC v. Zandford*, 535 U.S. 813, 820–21 (2002) ("Taking the allegations in the complaint as true, each sale was made to further respondent's fraudulent scheme; each was *deceptive because* it was neither authorized by, *nor disclosed to*, the [client].") (emphasis added).

[14] 17 C.F.R. § 240.10b-5(c) (2007).

[15] Br. for *Amici Curiae* States of Ark. *et al.* in Support of Petitioner at 14 n.4.

[16] *See, e.g., Ganino v. Citizens Util. Co.*, 228 F.3d 154, 167 (2d Cir. 2000) (explaining that under "truth on the market" corollary to "fraud on the market" doctrine, "a misrepresentation is immaterial
(Cont'd)

themselves did not result in any fraud—rather, investors were allegedly defrauded by Charter's later misrepresentations *about* the transactions. In *amici*'s words, "the plaintiffs' injuries are ultimately traceable to the false statements that Charter issued."[17]

B. A disclosure triggers a duty to speak truthfully, but a failure to disclose gives rise to securities-fraud liability only when it breaches a duty.

Fraud thus boils down to either a knowingly false or misleading disclosure, or a failure to disclose. Charter's false statements were fraudulent because Rule 10b-5(b) imposes a duty on speakers to disclose accurately and completely.[18] In Rule 10b-5(a) and (c) cases involving conduct, not speech, fraud arises from the defendant's failure to disclose his actions.[19] But when a defendant has made no false or misleading statements to investors, silence can give rise to fraud liability only when the defendant breaches a duty to speak. Thus, in *Chiarella v. United States*, the Court found that Section 10(b) incorporated the

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(Cont'd)
if the information is already known to the market because the misrepresentation cannot then defraud the market"); *cf. Basic Inc. v. Levinson*, 485 U.S. 224, 248 (1988) (holding that presumption of reliance in a fraud-on-the-market case may be rebutted by proving that "the 'market makers' were privy to the truth"); *In re Syntex Corp. Sec. Litig.*, 855 F. Supp. 1086, 1094 (N.D. Cal. 1994) (holding that defendant's truthful disclosure of its financial results relieved it of any duty to characterize those results).

[17] Br. for *Amici Curiae* States of Ark. *et al.* in Support of Petitioner at 17.

[18] *See, e.g., Rubin v. Schottenstein, Zox & Dunn*, 143 F.3d 263, 268 (6th Cir. 1998) (holding that Rule 10b-5(b) imposes a duty "to provide complete and non-misleading information with respect to subjects on which [a speaker] undertakes to speak").

[19] *See* Br. for *Amici Curiae* States of Ark. *et al.* in Support of Petitioner at 14 n.4 ("Because the securities laws are fundamentally directed at disclosure, at bottom, every injury premised on affirmative conduct can be reduced to a failure to disclose.") (citations omitted).

common-law principle that "one who fails to disclose material information prior to the consummation of a transaction commits fraud only when he is under a duty to do so."[20]

This duty is essential to any nondisclosure-based Section 10(b) claim. It renders the nondisclosure "deceptive" because the plaintiff is entitled to rely on the defendant for complete information.[21] In contrast, Stoneridge's "scheme" theory—also based on nondisclosure—would impose primary fraud liability on defendants that not only made no disclosures to shareholders, but also owed those shareholders no disclosure duty at all. As the Court has noted (and rejected), such duty-divorced liability would amount to "recognizing a general duty between all participants in market transactions" to disclose all material, nonpublic information or to forgo their transactions entirely.[22]

To say instead that the disclosure duty arises from "conduct"[23] likewise eradicates the duty requirement altogether, because an issuer's counterparties always engage in some "conduct"—whether they are buying goods, selling advertising, making loans, or structuring a transaction. By alleging undisclosed "conduct" as "primary" fraud—such as by artfully

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[20] 445 U.S. 222, 228 (1980).

[21] *See id.* at 234–35 ("Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud. When an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak."); *Regents of the Univ. of Cal. v. Credit Suisse First Boston (USA), Inc.*, 482 F.3d 372, 385 (5th Cir. 2007). The court in *Regents* concluded:

> It is natural to expect a plaintiff to rely on the candor of one who owes him a duty of disclosure, and it is fair to force one who breached his duty to prove that the plaintiff did not so rely. Here, however, where the plaintiffs had no expectation that the banks would provide them with information, there is no reason to expect that the plaintiffs were relying on their candor.

Id.

[22] *Chiarella*, 445 U.S. at 233.

[23] *See* Br. for *Amici Curiae* States of Ark. *et al.* in Support of Petitioner at 19.

pleading a legitimate transaction as a pejorative "sham"—private plaintiffs simply end-run and effectively eliminate the requirement for a preexisting duty. The resulting dutiless securities-fraud regime, and the expansive liability that would follow, are precisely what the statute does not authorize and this Court has repeatedly rejected.[24]

Instead, the Court has sought only to prevent the "inherent unfairness"[25] of parties exploiting, while failing to disclose, information to which they were afforded special access. In *Chiarella*, the Court adopted the Restatement of Torts' common-law formulation that, absent any false statements, a duty to disclose exists only "when one party has information 'that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.' "[26] Thus, the duty to disclose "arises from a *specific* relationship between two parties."[27] That relationship may exist among corporate insiders and shareholders[28] or brokers and their clients,[29] but it does not exist between a corporation's shareholders and

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[24] *See Dirks v. SEC*, 463 U.S. 646, 654–55 (1983) (observing that "[n]ot to require" a disclosure duty arising from a fiduciary relationship "would amount to 'recognizing a general duty between all participants in market transactions to forgo actions based on material, nonpublic information' ") (quoting *Chiarella*, 445 U.S. at 233); *id.* at 657 (rejecting "idea that the antifraud provisions require equal information"); *Chiarella*, 445 U.S. at 233 ("Formulation of such a broad duty . . . should not be undertaken absent some explicit evidence of congressional intent. As we have seen, no such evidence emerges from the language or legislative history of § 10(b).").

[25] *See In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S.E.C. 933, 936 (1968).

[26] *Chiarella*, 445 U.S. at 228 & n.9 (quoting Restatement (Second) of Torts § 551(2)(a) (1976)).

[27] *Id.* at 233 (emphasis added).

[28] *See, e.g., id.* at 228 (citing *In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961)).

[29] *See, e.g., SEC v. Zandford*, 535 U.S. 813, 823 (2002).

commercial third parties, such as the corporation's financial-services providers or its third-party vendors. Like the financial-printer employee in *Chiarella*, Scientific-Atlanta and Motorola were "complete stranger[s]" who never interacted with Charter's shareholders.[30] Imposing a duty to disclose to such remote parties would "depart[] radically from the established doctrine" and "should not be undertaken absent some explicit evidence of congressional intent," which, as the Court noted in *Chiarella*, does not exist.[31]

Amici Change to Win and the CtW Investment Group incorrectly rely on the common-law general "duty not to deceive."[32] As both the Court and the Restatement have acknowledged, that duty runs at most only to counterparties in business transactions—not to unidentified third parties (like the counterparty's shareholders) with whom the defendant never interacted or communicated.[33] The Fourth Circuit in *United*

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[30] *See Chiarella*, 445 U.S. at 232–33 ("[Chiarella] was not [the selling shareholders'] agent, he was not a fiduciary, he was not a person in whom the sellers had placed their trust and confidence. He was, in fact, a complete stranger who dealt with the sellers only through impersonal market transactions.").

[31] *Id.* at 233.

[32] *See* Br. for Change to Win & the CtW Inv. Group as *Amici Curiae* in Support of Petitioner at 16 ("Common law fraud also includes acts taken to conceal, create a false impression, mislead, or otherwise deceive in order to 'prevent[] the other [party] from acquiring material information,' even in the absence of a fiduciary, statutory, or other independent duty to disclose material information.") (citation omitted); Br. of the Am. Ass'n for Justice as *Amicus Curiae* in Support of Petitioner at 14.

[33] *See Stewart v. Wyo. Cattle Ranche Co., Ltd.*, 128 U.S. 383, 388 (1888) ("The gist of the action [for common-law fraud] is fraudulently producing a false impression *upon the mind of the other party* . . . .") (emphasis added); Restatement (Second) of Torts § 550 (1977) ("*One party to a transaction* who by concealment or other action intentionally prevents *the other* from acquiring material information is subject to the same liability . . . .") (emphasis added).

States v. Colton[34] reached the same result in construing the same words in the federal bank-fraud statute on which Stoneridge relies here—"scheme or artifice to defraud."[35] The court applied the common-law rule to conclude that the defendant had directly deceived his counterparty, the Resolution Trust Corporation, by failing to disclose material facts that allowed him to purchase a defaulted note at a discount.[36] Thus, contrary to *amici*'s urging,[37] *Colton*'s logic is no broader than the common law and, even if it applied to Rule 10b-5(a)'s similar language, would not reach defendants who never interacted or communicated with the complaining shareholders.

The common-law cases likewise consistently impose disclosure duties only on business adversaries.[38] Thus, under the common-law rule, Scientific-Atlanta's and Motorola's "duty not to deceive" would run to *Charter*—their business counterparty—not to anonymous Charter shareholders with whom they never interacted or communicated.[39] Even Change to Win's far-afield example of a car dealer resetting an odometer to deceive a buyer illustrates this limitation.[40] The dealer's

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[34] 231 F.3d 890 (4th Cir. 2000).

[35] *See* 18 U.S.C. § 1344 (2007).

[36] *See Colton*, 231 F.3d at 896–99.

[37] *See* Br. for Change to Win & the CtW Inv. Group as *Amici Curiae* in Support of Petitioner at 5, 13, 16 & 22.

[38] *See, e.g., Salzman v. Maldaver*, 24 N.W.2d 161 (Mich. 1946) (aluminum seller concealed corroded sheets from buyer and interfered with buyer's ability to inspect); *Lindberg Cadillac Co. v. Aron*, 371 S.W.2d 651 (Mo. Ct. App. 1963) (seller painted over engine-block crack to conceal it from buyer); *Berkowitz v. Lyons*, 119 A. 20 (N.J. 1922) (seller sold buyer stolen automobile).

[39] *See, e.g., Sachs v. Blewett*, 185 N.E. 856, 858 (Ind. 1933) (dismissing fraud claim where complaint did not allege "any relationship of trust or confidence between the parties, nor are any circumstances shown which would entitle the [plaintiff] to place more than ordinary reliance in the promises of the [defendants]").

[40] *See Dist. Motor Co. v. Rodill*, 88 A.2d 489, 494 (D.C. Ct. App. 1952); Restatement (Second) of Torts § 525 cmt. b (1977).

duty—to disclose the reset odometer or abstain from selling the car—runs only to the buyer, not to the buyer's constituents or subsequent counterparties. This is similar to the duty to disclose or abstain that the Court has held must arise from a "specific relationship between two parties."[41] And of course, the odometer example is several steps removed from this case—unlike the car dealer whose conduct amounts to an affirmative representation about the car under his control, Charter's third-party vendors made no representations (through either words or conduct) to Charter's shareholders and did not control the contents of Charter's financial statements.

C. Stoneridge's non-duty-based Section 10(b) theory would create litigation exposure to anonymous third-parties, raising the cost of accessing the U.S. capital markets without benefiting investors.

Abandoning the duty to disclose as a prerequisite to Section 10(b) liability would expose literally all participants in commercial transactions with public issuers to private securities-fraud litigation—even if they never deceived anyone or uttered a word publicly. For financial institutions, which collectively do business with virtually every company seeking access to the U.S. capital markets, the consequences of Stoneridge's non-duty theory would be especially acute. It would force them to police issuers' disclosures for accuracy and completeness or, worse, implement their own disclosure regime for every transaction with a public company.[42] It would also place financial institutions in the impossible role of assessing a disclosure's materiality to their *counterparty's* shareholders while lacking

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[41] *Chiarella*, 445 U.S. at 233.

[42] *See Dirks v. SEC*, 463 U.S. 646, 653 n.12 (1983) ("The SEC views the disclosure duty as requiring more than disclosure to purchasers or sellers: 'Proper and adequate disclosure . . . can only be effected by a public release through the appropriate public media, designed to achieve a broad dissemination to the investing public generally and without favoring any special person or group.' ") (quoting *In re Faberge, Inc.*, 45 S.E.C. 249, 256 (1973)).

complete and accurate information themselves. Setting aside the potential exposure to the counterparty that a misinformed disclosure could create, and the practical conflict if the counterparty were to insist on typical confidentiality protections, such a result would only harm investors by burying them in an avalanche of countless, potentially conflicting disclosures from an issuer's commercial counterparties. As the Court has observed, such information-overload is "hardly conducive to informed decision making."[43]

In other words, Stoneridge's non-duty-based private-right-of-action theory would lead to precisely the "ripple effects" that the Court in *Central Bank* aimed to avoid: "newer and smaller companies may find it difficult" to obtain securities and financial advice and to access the U.S. capital markets, and the financial institutions' "increased costs . . . may be passed on to their client companies, and in turn incurred by the company's investors, the intended beneficiaries of the statute."[44] The additional compliance costs and litigation expense—not to mention liability risk—would be staggering. Every transaction for which an allegation could be constructed that passes Stoneridge's proposed "purpose and effect" test[45] could put financial institutions at risk for the entire amount of the *issuer's* fraud, as

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[43] *See Basic Inc. v. Levinson*, 485 U.S. 224, 231 (1988) (recognizing that the Court must be "careful not to set too low a standard of materiality" because "a minimal standard might bring an overabundance of information within its reach, and lead management simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decision making") (internal quotations omitted).

[44] *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 189 (1994).

[45] Br. for Petitioner at 32 ("A person engages in a deceptive act as part of a scheme to defraud investors, and violates Section 10(b) and Rule 10b-5(a) and/or (c), if the purpose and effect of his conduct is to create a false appearance of material fact in furtherance of that scheme.").

the PSLRA's proportionate-liability protection does not apply to knowing violations.[46] Access to U.S. capital markets would become more expensive as investors and their companies bear the higher transaction costs to compensate financial institutions for soaring expenses. Foreign markets—which limit or prohibit private class actions—would become more attractive to both U.S. and foreign companies, depriving American investors of *bona fide* investment opportunities.[47] The end result: securities class-action litigation, which is already cited as a key deterrent to foreign issuers considering entry into U.S. markets,[48] would continue to sabotage the competitive footing of U.S. capital markets.

These consequences are not a matter of idle speculation. Securities-plaintiffs' lawyers have concocted numerous costly litigation theories post-*Central Bank*—including against SIFMA and FIA members—giving rise to the conflicting circuit rulings that precipitated this appeal.[49] And foreign commentators are

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[46] *See* 15 U.S.C. § 78u-4(f)(2)(A) (2007).

[47] *See* H.R. Rep. No. 104-50, at 20 (1995) ("Fear of [securities] litigation keeps companies out of the capital markets.").

[48] Interim Report of the Committee on Capital Markets Regulation at 11 (2006), *available at* http://www.capmktsreg.org/pdfs/11.30 Committee_Interim_ReportREV2.pdf ("Foreign companies commonly cite the U.S. class action enforcement system as the most important reason why they do not want to list in the U.S. market.").

[49] *Compare, e.g., Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040, 1048 (9th Cir. 2006) (holding that primary liability arises from "conduct that had the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme"); *and In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 504 (S.D.N.Y. 2005) (sustaining claims for primary Section 10(b) violations where complaint alleged that secondary actors had "used or employed a[] device or contrivance with the capacity or tendency to deceive"); *with Regents of the Univ. of Cal. v. Credit Suisse First Boston (USA), Inc.*, 482 F.3d 372, 384 (5th Cir. 2007) (holding that " 'deception' within the meaning of § 10(b) requires that a defendant (Cont'd)

already watching this case closely for fear that Stoneridge's scheme-liability theory, if endorsed, would impose new barriers to foreign trade and investment, and damage transatlantic economic relations.[50]

These adverse consequences greatly outweigh any *de minimis* benefit that an expanded securities-fraud class-action regime might provide. While federal law authorizes appropriate securities-fraud actions, all securities class actions merely pit one group of shareholders against another—the innocent shareholders who happen to own the company when the suit is brought.[51] Indeed, many shareholders—particularly the institutional investors likely to serve as lead plaintiffs—are often on both sides and essentially end up paying themselves (minus substantial attorneys' fees).[52]

Expanding private class actions through Stoneridge's non-duty theory would only increase the likelihood of this circular wealth transfer because the issuer's and the secondary actors' respective shareholders often overlap. Common lead plaintiffs like pension funds and other diversified institutional investors typically own large stakes in the financial-services companies

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fail to satisfy a duty to disclose material information to a plaintiff" and rejecting plaintiffs' theory that "[m]erely pleading that defendants failed to fulfill that duty by means of a scheme or an act" constitutes § 10(b) deception); *and In re Dynegy, Inc. Sec. Litig.*, 339 F. Supp. 2d 804, 916 (S.D. Tex. 2004) (dismissing claims against secondary actor for "structuring, funding, and executing" transactions that issuer falsely reported because "plaintiffs cannot invoke subsections (a) and (c) of Rule 10b-5 to circumvent *Central Bank*'s limitations on liability for a secondary actor's involvement in the preparation of false and misleading statements").

[50] *See generally* Br. of Org. for Int'l Inv. *et al.* as *Amici Curiae* in Support of Respondents.

[51] *See* Interim Report of the Committee on Capital Markets Regulation, *supra* note 48, at 11.

[52] *See id.*

that the non-duty theory would most likely affect. For example, the New York State Common Retirement Fund owns more than $2.5 billion of stock in Bank of America, Citigroup, and JPMorgan Chase & Co.[53] Even individual investors with moderately diversified portfolios or mutual-fund ownership would be on both sides in a multi-defendant scheme-liability action. For this reason, a commentator on which the Stoneridge *amici* rely concludes that "[f]rom a compensatory perspective . . . the securities class action performs poorly."[54]

Treasury Secretary Paulson has crystallized the relevant policy concerns: "Our markets are, indeed, the best in the world. Yet we must be vigilant, and we must do everything we can to ensure they stay that way. . . . [T]he fundamental question we must ask is: Have we struck the right balance between investor protection and market competitiveness . . . ?"[55] A non-duty scheme-liability regime advances neither.

D. In contrast to the clear standard that the duty requirement provides, Stoneridge's proposed "purpose and effect" test would create uncertainty and roll back Congress's consistent post-*Central Bank* efforts to limit private securities class actions.

The Court in *Central Bank* emphasized the need for certainty and predictability in Section 10(b) litigation,[56] which,

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[53] *See* N.Y. State Common Ret. Fund Asset Listing as of March 31, 2006, at 8, 14 & 30, *available at* http://www.osc.state.ny.us/retire/word_and_pdf_documents/publications/cafr/asset_listings_06.pdf.

[54] John C. Coffee, Jr., *Reforming the Securities Class Action: an Essay on Deterrence and Its Implementation*, 106 Colum. L. Rev. 1534, 1545 (2006).

[55] Opening Remarks by Treasury Secretary Henry M. Paulson, Jr. at Treasury's Capital Markets Competitiveness Conference (Mar. 13, 2007), http://www.ustreas.gov/press/releases/hp306.htm.

[56] *See Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 188 (1994) (quoting *Pinter v. Dahl*, 486 U.S. 622, 652 (1988)).

as the Court has long recognized, "presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general."[57] Without clear standards, decisions are " 'made on an ad hoc basis, offering little predictive value' to those who provide services to participants in the securities business."[58] This uncertainty only increases the *in terrorem* effect inherent in securities-fraud class actions that lends them "a settlement value to the plaintiff out of any proportion to its chance of success at trial."[59] By adhering to the duty to disclose as a prerequisite to Rule 10b-5(a) and (c) liability, this Court would maintain the clear standard that curtails such abuse.

A looser standard—such as Stoneridge's proposed "purpose and effect" test[60]—would ensnare legitimate business conduct in private securities-fraud class-action litigation. Financial institutions design structured-finance transactions, for example, to confer legitimate legal, tax, or accounting benefits, but the complex and dynamic governing rules make such transactions particularly susceptible to securities class-action abuse.[61] Indeed, such abusive litigation has already gained traction in lower courts

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[57] *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739 (1975); *see also Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2504 (2007) ("Private securities fraud actions, however, if not adequately contained, can be employed abusively to impose substantial costs on companies and individuals whose conduct conforms to the law.").

[58] *Cent. Bank*, 511 U.S. at 188 (quoting *Pinter*, 486 U.S. at 652); *see also Blue Chip Stamps*, 421 U.S. at 755 ("We do not believe that such a shifting and highly fact-oriented disposition of the issue of who may bring a damages claim for violation of Rule 10b-5 is a satisfactory basis for a rule of liability imposed on the conduct of business transactions.").

[59] *Blue Chip Stamps*, 421 U.S. at 740.

[60] Br. for Petitioner at 32.

[61] *See generally* Br. of the Am. Bankers Ass'n *et al.* as *Amici Curiae* in Support of Respondents at 17–20.

that have applied vague standards similar to what Stoneridge is proposing here.[62] As one district court explained, even though the transactions depicted in the complaint may well have been legitimate, the court was bound at the pleadings stage to sustain securities-fraud claims against the financial-institution defendant.[63]

Even under the newly strengthened *scienter* pleading standard that the Court announced in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*,[64] Stoneridge's nebulous "purpose and effect" test would nevertheless reward plaintiffs for cherry-picking disadvantageous facts—which cannot necessarily be countered on a motion to dismiss—and ignoring legitimate business justifications. The likely outcome would be to penalize legitimate capital-raising behavior by adding the unnecessary litigation costs and coercive settlement payments that the Court has condemned.[65]

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[62] *See supra* note 49 and accompanying text.

[63] *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 504 n.160 (S.D.N.Y. 2005). The court observed:

> [I]t is possible that Parmalat never sold bad invoices to Citigroup but simply misrepresented the effect of the securitization transactions on its financial health. On this view, the relevant allegations likely would fail to state a claim against Citigroup [because] Citibank would not have committed a deceptive act but rather merely facilitated Parmalat's misstatements. At this stage, however, the Court is obliged to draw from the complaint all reasonable inferences in the plaintiffs' favor and therefore assumes for present purposes that Citigroup securitized worthless invoices.

Id.

[64] 127 S. Ct. 2499, 2513 (2007) ("A plaintiff alleging fraud in a § 10(b) action, we hold today, must plead facts rendering an inference of scienter *at least as likely as* any plausible opposing inference.").

[65] *See Cent. Bank*, 511 U.S. at 189 ("Because of the uncertainty of the governing rules, [defendants] may find it prudent and necessary, as a business judgment, to abandon substantial defenses and to pay settlements in order to avoid the expense and risk of going to trial.").

Stoneridge's relaxed "purpose and effect" test would thus roll back Congress's efforts to contain frivolous private securities-fraud litigation at the pleadings stage. Congress has noted the importance of a rigorous standard to prevent strike-suit plaintiffs from leveraging the burden and expense of discovery into a nuisance-value settlement.[66] To that end, Congress has legislated repeatedly over the past twelve years to restrict private securities class-action litigation. In 1995—the year after *Central Bank*—Congress enacted the PSLRA to rein in the rampant securities class actions that were "being used to injure 'the entire U.S. economy.' "[67] Consistent with that approach, Congress chose *not* to expand Section 10(b)'s private right of action to include aiding-and-abetting or conspiracy liability, even though it extended the SEC's enforcement authority to exactly that conduct.[68] Similarly in 1998, Congress enacted SLUSA to stop private plaintiffs from circumventing the PSLRA by filing the same frivolous securities lawsuits in state court.[69] And even after the highly publicized corporate scandals of 2001 and 2002, Congress responded (in the Sarbanes-Oxley Act) by legislating more stringent corporate-governance requirements and greater SEC enforcement

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[66] *See* S. Rep. No. 104-98, at 7 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 686 ("If a defendant cannot win an early dismissal of the case, 'the economics of litigation may dictate a settlement even if the defendant is relatively confident that it would prevail at trial.' ") (quoting then-SEC Chairman Arthur Levitt); *see also Cent. Bank*, 511 U.S. at 189 (noting Congress's concern over the excessive sums that secondary actors are forced to spend "even for pretrial defense and the negotiation of settlements") (citing 138 Cong. Rec. S12605 (Aug. 12, 1992) (remarks of Sen. Sanford)).

[67] *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 81 (2006) (quoting H.R. Rep. No. 104-369, at 31 (1995)) (discussing PSLRA's legislative history and purpose).

[68] *See* 15 U.S.C. § 78t(e) (2007).

[69] *See* 15 U.S.C. § 77p(b) (2007) (preempting any "covered class action based upon the statutory or common law of any State" that alleges securities fraud).

authority[70]—and *rejected* the expansion of private securities-fraud liability that Stoneridge urges here.[71]

II. EXISTING FEDERAL AND STATE LAWS PROVIDE ADEQUATE DETERRENCE AGAINST POTENTIAL AIDERS AND ABETTORS AND AMPLE INVESTOR PROTECTION.

Stoneridge sounds a false alarm by declaring that the Court's unwillingness to expand "scheme liability" would "create a moral hazard encouraging fraud."[72] It depicts a doomsday scenario in which secondary actors would be emboldened to aid and abet others' fraud.[73] Stoneridge's hyperbole is flatly refuted by the ample deterrence of aiding and abetting, and means for restitution, that exist from (i) numerous federal criminal, regulatory, and civil penalties; and (ii) state-law regulatory consequences.

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[70] *See, e.g.*, 15 U.S.C. § 7241(a) (2007) (requiring issuer's "principal executive officer or officers and principal financial officer or officers" to certify the "effectiveness of the issuer's internal controls"); *id.* § 7262(a) (requiring issuers' annual reports to include an "internal control report" that states management's responsibility "for establishing and maintaining an adequate internal control structure and procedures for financial reporting"); *see also* Sarbanes-Oxley Act of 2002, Pub. L. No. 107–204, § 3 (2002) (conferring on the SEC the power to enforce all provisions of the Act).

[71] *See* 148 Cong. Rec. S6575-02, S6584 (daily ed. July 10, 2002) (describing Senator Shelby's proposed amendment to include a "private litigation" provision that "persons that aid or abet violations . . . shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided"); *see also* H.R. Rep. No. 107-414, at 54 (2002) (lamenting that Congress did not "heed these recommendations" to expand the private right of action).

[72] Br. for Petitioner at 35.

[73] *Id.* ("[C]ompanies will quickly learn that they can get away with fraud.").

A. Federal criminal penalties are a professional death sentence for most secondary actors, including financial institutions.

The Justice Department's vigorous prosecution of securities-law violations provides a potent deterrent to aiding and abetting fraud. Since its creation in 2002, the Corporate Fraud Task Force has charged more than 1,300 defendants and secured more than a thousand corporate fraud convictions, including the convictions of a hundred CEOs or corporate presidents.[74] The Department's success is partly attributable to its broad statutory powers to punish secondary actors who assist others in committing securities fraud—the same targets of Stoneridge's suit here. That is, the United States Code criminalizes aiding and abetting violations of the securities laws and mail and wire fraud,[75] as well as conspiracy to violate those laws.[76] Prosecutors are further able to return ill-gotten gains directly to injured shareholders through restitution and forfeiture[77]—without the hefty contingency-fee payout to plaintiffs' lawyers.

The threat of a criminal indictment is a serious deterrent—because even an indictment, and certainly a conviction, would amount to a professional death sentence.[78] One need look no

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[74] *See* U.S. Dep't of Justice, Fact Sheet: Corporate Fraud Task Force (Aug. 9, 2006), *available at* http://www.usdoj.gov/opa/pr/2006/August /06_odag_521.html.

[75] *See* 18 U.S.C. § 2 (2007).

[76] *See id.* § 371.

[77] *See id.* § 3572 (restitution must be paid before fines and penalties); *id.* § 981(a)(1)(D) & (E) (forfeiture of proceeds from mail and wire fraud).

[78] *See, e.g.*, Kurt Eichenwald, *Brokerage Firm Admits Crimes in Energy Deals*, N.Y. TIMES, Oct. 28, 1994, at A1 (" '[C]riminal prosecution of these types of [securities] firms can be the equivalent of the corporate death penalty . . . .' ") (quoting former SEC Commissioner Joseph Grundfest).

further for evidence than Arthur Andersen LLP, which was forced to shut its doors and terminate most of its 28,000 U.S. (and 85,000 worldwide) employees[79] after a conviction on just one obstruction-of-justice count (that was ultimately reversed).[80] Before Arthur Andersen, Drexel Burnham Lambert—once the nation's fifth largest securities firm—collapsed and laid off 5,400 employees after pleading guilty to securities charges.[81] And these existence-threatening risks are not limited to Wall Street and corporate America; they affect any business that depends on its reputation and the public's trust. For example, two major plaintiffs' law firms have recently struggled to retain clients following a criminal investigation and indictment[82] because, as one lead plaintiff declared, the "indictment so taint[s the firm] that neither it nor its attorneys—even those not specifically targeted . . . should continue to serve as class counsel."[83]

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[79] Jonathan D. Glater, *Last Task at Andersen: Turning Out the Lights*, N.Y. TIMES, Aug. 30, 2002, at C3.

[80] *See Arthur Andersen LLP v. United States*, 544 U.S. 696 (2005) (reversing obstruction-of-justice conviction).

[81] *See Key Events in the Prosecution*, N.Y. TIMES, Apr. 21, 1990, at 1; Pat Widder, *Timing Helps Salomon Beat Drexel's Fate*, CHI. TRIB., May 24, 1992, at C1 ("Drexel paid $650 million, pleaded guilty to six felonies and floundered; the firm was driven into bankruptcy.").

[82] *See, e.g.*, Order, *In re New Motor Vehicles Can. Exp. Antitrust Litig.*, 03-MDL-01532-DBH (D. Me. Dec. 18, 2006) (granting motion to remove Milberg Weiss from leadership position in multi-district litigation because of criminal indictment's taint); Order, *In re Medtronic, Inc. Implantable Defibrillator Prod. Liab. Litig.*, 05-MDL-1726-JMB-AJB (D. Minn. June 5, 2006) (ordering *sua sponte* the removal of Milberg Weiss from the Plaintiffs' Steering Committee—even though there were no allegations that the attorney handling case had violated any laws—because of firm's criminal indictment); Order, *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, No. 02-CV-1152-M (N.D. Tex. Feb. 28, 2007) (granting lead plaintiffs' motion to replace Lerach as lead counsel).

[83] Reply Br. of Lead Pl. in Support of Mot. for Substitution of Lead Counsel at 7, *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, No. 02-CV-1152-M (N.D. Tex. Dec. 27, 2006).

Even when corporate defendants are able to avoid criminal prosecution by cooperating with the government, they still face stiff financial penalties and reputational damage. For example, CIBC was forced to exit *entirely* the U.S. structured-finance business—a legitimate and profitable field for financial institutions—as part of its deferred-prosecution agreement arising from Enron.[84] In a similar agreement relating to its tax-shelter practice, the accounting firm KPMG agreed to pay a *$456 million* penalty and abandon three of its businesses to avoid criminal charges that KPMG "knew . . . would probably kill it."[85]

And on facts similar to *Stoneridge*, AOL/Time Warner agreed to pay $210 million in investor restitution and penalties to resolve charges of aiding and abetting PurchasePro's revenue misstatements.[86] The criminal complaint had charged AOL with entering sham transactions (in which AOL received $70 million plus stock warrants) that its counterparty, PurchasePro, later used to report inflated revenue. Illustrating the pressure that prosecutors can exert, the $210 million that AOL paid to resolve the criminal charges was *greater* than the benefit it received from the challenged transaction.

This case itself illustrates that the government can and will punish vendor conduct that aids and abets an issuer's fraud on the market. As Stoneridge notes,[87] four Charter officers were

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[84] Press Release, U.S. Dep't of Justice, Canadian Imperial Bank of Commerce Agrees to Cooperate with Enron Investigation (Dec. 22, 2003), *available at* http://www.usdoj.gov/opa/pr/2003/December/03_crm_718.htm.

[85] David Reilly, *Narrow Escape: How a Chastened KPMG Got by Tax-Shelter Crisis — Boss of Just Three Days Admitted Firm's Sins, Fought to Keep Clients*, WALL ST. J., Feb. 15, 2007, at A1.

[86] *See* Press Release, U.S. Dep't of Justice, America Online Charged with Aiding and Abetting Securities Fraud (Dec. 15, 2004), *available at* http://www.fbi.gov/dojpressrel/pressrel04/aolrelease121504.htm.

[87] Br. for Petitioner at 37.

indicted for their roles in the alleged transactions on 14 counts of mail fraud,[88] wire fraud,[89] conspiracy to commit mail and wire fraud,[90] and aiding and abetting mail and wire fraud.[91] The charges led to guilty pleas, a combined 26 months of prison time, and $775,000 in personal fines.[92]

B. The SEC has responded to Congress's decision to expand its—and not private plaintiffs'—enforcement and recovery powers.

The SEC's broad powers and lengthy record of pursuing wrongdoers and returning funds to investors further belie the Stoneridge *amici*'s argument that the government is "ill-equipped" to enforce the securities laws on a large scale.[93] Indeed, Congress thought just the opposite when it expanded the SEC's mandate in 1995 to include bringing suits against secondary actors for aiding and abetting securities violations.[94] And by passing the Sarbanes-Oxley Act's FAIR Funds provision, Congress once again rejected a proposal to overrule *Central Bank* by expanding private litigation to include aiding and abetting,[95] instead favoring greater SEC enforcement authority. It directed the SEC to create a fund to collect and return to injured investors monies that the SEC recovers through disgorgement and civil penalties.[96]

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[88] *See* 18 U.S.C. § 1341 (2007).

[89] *See id.* § 1343.

[90] *See id.* § 371.

[91] *See id.* § 2.

[92] Judgment, *United States v. Barford*, No. 4:03CR00434 (E.D. Mo. Apr. 22, 2005); Judgment, *United States v. Kalkwarf*, No. 4:03CR434 (E.D. Mo. Apr. 22, 2005); Judgment, *United States v. McCall*, No. 4:03CR434 (E.D. Mo. Apr. 22, 2005); Judgment, *United States v. Smith*, No. 4:03CR434 (E.D. Mo. Apr. 22, 2005).

[93] *See* Br. of the N. Am. Sec. Adm'rs Ass'n, Inc. as *Amicus Curiae* in Support of Petitioner at 19.

[94] *See* 15 U.S.C. § 78t(e) (2007).

[95] *See supra* note 71 and accompanying text.

[96] *See* 15 U.S.C. § 7246 (2007).

The FAIR Funds provision's sponsors sought to compensate investors without incurring the high legal fees associated with private class-action litigation and to ensure that "[t]his money is [used] for investors' retirement accounts, not oceanfront estates for ambulance-chasing trial lawyers."[97] The statute is thus designed to recapture "[n]inety percent or more of forfeited ill-gotten gains . . . [for] injured investors"[98]—a huge benefit considering that legal fees can account for a substantial portion of any private recovery, even when institutional or state plaintiffs have the leverage to " 'drive a hard[] bargain' with law firms."[99] In Ohio's securities class-action settlement with AOL, for example, $31 million of the $175 million settlement went to pay the plaintiffs' lawyers' fees and expenses.[100]

The SEC has embraced its increased authority. From 2002 to 2006, it collected more than *$8 billion* for distribution to investors through the FAIR Funds program.[101] And just as the Justice Department has used its criminal powers against vendors who aid and abet an issuer's fraud on the market, the SEC has similarly used its enforcement authority. In fact, it has already obtained large recoveries from Scientific-Atlanta and Motorola for their alleged aiding and abetting.[102] The SEC has (i) sued

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[97] *See* Press Release, Office of Rep. Richard H. Baker, U.S. House of Representatives, Returning Funds to Defrauded Investors (Jul. 17, 2002) (announcing proposed FAIR Funds provision to the Sarbanes-Oxley Act) (quoting Rep. Michael G. Oxley); *see also id.* ("Unless we act on behalf of investors, this money merely will be transferred from greedy corporate executives to greedy trial lawyers.") (quoting Rep. Michael G. Oxley).

[98] *See id.*

[99] Peter Krouse, *Ohio Gains $144 Million for Pensions in Settlement*, CLEVELAND PLAIN DEALER, Mar. 8, 2007, at A1.

[100] *See id.*

[101] *See* SEC, 2006 Performance and Accountability Report at 23 (2006), *available at* http://www.sec.gov/about/secpar2006.shtml.

[102] *See* Br. for Petitioner at 37.

Scientific-Atlanta for entering transactions with another cable company that were nearly identical to those it entered with Charter; (ii) recovered $20 million in disgorgement through a settlement with Scientific-Atlanta;[103] and (iii) recovered $25 million in civil penalties from Motorola for the same conduct.[104]

Not only can the SEC sue secondary actors as aiders and abettors under Section 20(e),[105] it can also sue them for violating Section 13 (as it did Scientific-Atlanta),[106] which addresses the accuracy of corporate books and records. Rule 13b2-2(b)(1),[107] which the SEC adopted to enforce Section 303(a) of the Sarbanes-Oxley Act,[108] applies *primary liability* to customers, vendors, creditors, accountants, attorneys, securities professionals, or other advisors who, under the direction or request of an issuer's officers or directors, (i) provide false or misleading information to auditors, (ii) enter into "side agreements" that enable issuers to mislead auditors, or (iii) place pressure on auditors that compromises the audit report's integrity.[109] Accordingly, if a secondary actor provides false

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[103] *See SEC v. Scientific-Atlanta, Inc.*, SEC Litig. Release No. 19735 (Jun. 22, 2006), *available at* http://www.sec.gov/litigation/litreleases/2006/lr19735.htm.

[104] *See In re Motorola, Inc.*, SEC Exchange Act Release No. 55,725 (May 8, 2007), *available at* http://www.sec.gov/litigation/admin /2007/34-55725.pdf.

[105] *See* 15 U.S.C. § 78t(e) (2007).

[106] *See id.* § 78m(b) (2007); *see also supra* note 103 and accompanying text.

[107] *See* 17 C.F.R. § 240.13b2-2(b)(1) (2007) ("No officer or director of an issuer, or *any other person acting under the direction thereof*, shall directly or indirectly take any action to coerce, manipulate, mislead, or fraudulently influence any independent public or certified public accountant engaged in the performance of an audit or review of the financial statements . . . .").

[108] 15 U.S.C. § 7242(a) & (b) (2007).

[109] Improper Influence on Conduct of Audits, Exchange Act Release No. 34–47890, Investment Company Act Release No. 26,050, 68 Fed. Reg. 31820, 31821–22 (2003).

documents to an issuer's auditor—even without uttering a word publicly—the SEC also could sue it as a primary Rule 13b2-2(b)(1) violator.

In addition to the SEC's enforcement power, it also oversees self-regulatory organizations, such as the Financial Industry Regulatory Authority,[110] which can bring disciplinary actions against securities firms and their employees who aid and abet another's Section 10(b) violation.[111]

C. State penalties and recovery methods broadly encompass aiding and abetting securities-law violations.

Besides the formidable deterrence the DOJ, SEC, and SROs provide, a broad array of state-law penalties also deters secondary actors from aiding securities violations. These include state "blue sky" laws that permit attorneys general and state regulators to seek fines and obtain restitution from,[112] and impose

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[110] The Financial Industry Regulatory Authority ("FINRA") is the nongovernmental regulatory body created in 2007 by the consolidation of the National Association of Securities Dealers, Inc. and the New York Stock Exchange's regulation, enforcement, and arbitration functions. FINRA currently regulates all securities firms doing business in the United States.

[111] *See Dep't of Enforcement v. Perles*, CA F980005, 2000 NASD Discip. LEXIS 9, at *20–24 (Aug. 16, 2000) (holding that *Central Bank* does not apply to NASD's interpretation of its own Conduct Rules and that aiding and abetting another's securities fraud violates NASD Conduct Rule 2110), *aff'd in relevant part*, Exchange Act Release No. 45691, 2002 SEC LEXIS 847 (Apr. 4, 2002); *see also, e.g., Dep't of Enforcement v. J. Alexander Sec., Inc.*, CA F010021, 2004 NASD Discip. LEXIS 16, at *45–46, 65–69 (Aug. 16, 2004) (holding that aiding and abetting another's securities fraud violates NASD Conduct Rule 2110, and barring aider and abettor from associating with any NASD firm).

[112] *See, e.g.*, Del. Code Ann. tit. 6, § 7325 (2007) (permitting the commissioner to fine and order restitution form any person "who aids and abets any person who wilfully violates any provision of [the

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criminal sanctions against,[113] anyone who aids state securities-law violations. For example, in recent years, the New York attorney general has successfully used New York's Martin Act to recover more than $5 billion in securities-fraud settlements.[114] And state attorneys general have actively pursued aiders and abettors.[115]

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Delaware Securities Act]"); Cal. Corp. Code §§ 25403(b), 25530–25536 (2007) (permitting the commissioner to take action against any person who knowingly provides substantial assistance to another's violation of California's securities laws); *State v. McLeod*, 12 Misc. 3d 1157(A), 2006 WL 1374014, at *11 (N.Y. Sup. Ct. 2006) (holding that a defendant's mere participation in another's stock-spinning scheme "is sufficient to subject [that defendant] to the Martin Act's reach") (citing N.Y. Gen. Bus. Law, Art. 23-A §§ 352(1) & 352-c(2)).

[113] *See, e.g.*, N.Y. Gen. Bus. Law, Art. 23-A §§ 352-c(4)–(6), 352-d, 358 (authorizing criminal penalties and prosecution for violations of Martin Act's anti-fraud provisions); Del. Code Ann. tit. 6, § 7325 (2007) (authorizing criminal prosecution of any person who willfully aids and abets a violation of securities laws); Cal. Corp. Code §§ 25540–25542 (same); 815 Ill. Comp. Stat. § 5/14 (same).

[114] Paul Davies, *Spitzer's Successor May Not Follow in His Footsteps—Cuomo Targets Medicaid Fraud, Guns, Government Corruption; Grasso Case Will Be Early Test*, WALL ST. J., Nov. 11, 2006, at B1.

[115] *See, e.g.*, Press Release, N.Y. State Att'y Gen., Former Trust Company Officials Arrested in Late Trading Fraud (Nov. 25, 2003) (announcing that the combined efforts of the New York Attorney General, SEC, and Office of the Comptroller of Currency had resulted in felony charges against three of Security Trust Co.'s executives for assisting in mutual-fund late trading and had led to the firm's dissolution), *available at* http://www.oag.state.ny.us/ press/2003/nov/nov25a_03.html; *SEC v. J.P. Morgan Chase & Co.*, SEC Litig. Release No. 18252 (Jul. 28, 2003) (announcing civil complaint and $135 million settlement achieved "in coordination with the New York County District Attorney's Office" arising from bank's aiding and abetting accounting fraud), *available at* http://www.sec.gov/litigation/litreleases/lr18252.htm; *SEC v. Southmark*
(Cont'd)

CONCLUSION

The essence of securities fraud is making material misstatements or failing to disclose despite a duty to do so. That is fair game for private securities-fraud liability. The securities laws do not, however, allow private plaintiffs to sue third parties that owed them no duties and indeed may never have deceived them at all. Yet that is precisely what Stoneridge's scheme-liability theory would accomplish. For financial institutions that collectively do business with virtually every company seeking to access the U.S. capital markets, the consequences of applying Stoneridge's radical liability theory would be especially costly. Added litigation and compliance costs would further weigh down the U.S. capital markets in the global race to lure companies and investors. And this handicap would yield no corresponding benefits, considering the litany of other fraud deterrents and investor remedies. In the end, the only clear winners would be plaintiffs' lawyers, who would have won the right to sue additional parties for the issuer's fraud, all in pursuit of deep pockets to pay higher fees. Congress has repeatedly refused to give the lawyers that windfall, and this Court should decline that same invitation. The Court of Appeals' judgment should be affirmed.

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